

**MINUTES
of the
FIFTH MEETING
of the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE**

**October 17, 2007
Room 307, State Capitol
Santa Fe**

The fifth meeting of the Investments and Pensions Oversight Committee (IPOC) for the 2007 interim was called to order by Senator John Arthur Smith, chair, on Tuesday, October 17, 2007, at 10:15 a.m. at the State Capitol in Santa Fe.

Present

Sen. John Arthur Smith, Chair
Rep. Donald E. Bratton
Rep. Larry A. Larrañaga
Sen. Mary Kay Papen
Rep. Henry Kiki Saavedra
Rep. Luciano "Lucky" Varela

Absent

Rep. John A. Heaton, Vice Chair
Sen. Joseph J. Carraro
Sen. Phil A. Griego
Sen. Carroll H. Leavell
Rep. Jim R. Trujillo

Advisory Members

Rep. Andrew J. Barreras
Gary Bland, State Investment Council
Amy Chavez for Olivia Padilla-Jackson,
State Board of Finance
Rep. Miguel P. Garcia
Bob Gish, Public Employees Retirement
Association
Bob Jacksha, Educational Retirement
Board
Rep. Patricia A. Lundstrom
Joelle Mevi for James Lewis,
State Treasurer
Rep. John Pena
Rep. Jane E. Powdrell-Culbert
Rep. Sheryl Williams Stapleton

Sen. Pete Campos
Sen. Carlos R. Cisneros
Sen. Stuart Ingle
Sen. Leonard Lee Rawson
Sen. Michael S. Sanchez
Sen. H. Diane Snyder
Rep. Eric A. Youngberg

Staff

Norton Francis, Legislative Finance Committee (LFC)
Cleo Griffith, Legislative Council Service (LCS)
Larry Matlock, LCS
Doug Williams, LCS

Guests

The guest list is in the meeting file.

Wednesday, October 17

The committee adopted the minutes of the September 5, 2007 meeting.

State Fire Marshal Retirement — Vernon Muller, Deputy State Fire Marshal

The Fire Marshal's Office is seeking 20-year retirement. The change in benefits would affect 25 employees.

Senator Smith commented that before the legislature makes any changes in retirement benefits, it must be demonstrated that the state will be able to honor its commitment to the retirees. He stressed that he is not opposed to the enhancement of benefits, but wants to be certain that the state can afford the long-term cost.

Representative Larrañaga asked about the status of an actuarial study. Mr. Muller responded that negotiations with the Public Employees Retirement Association (PERA) have begun, and it is anticipated that a study will be completed in November. Terry Slattery, executive director, PERA, added that the study will examine the impact of adding the Fire Marshal's Office to the state police plan. If the fire marshal employees join the state police plan, the employee contribution will increase from 7.14% to 7.60%. The employer contribution will increase from 16.14% to 25%.

Representative Bratton noted that the change would also affect the Retiree Health Care Authority solvency. He also stated that there are high-risk jobs in the private sector, but 20-year retirement is not typical. He commented that the legislature needs to be fair to the tax-paying public.

Representative Lundstrom commented that she believes the enhanced retirement benefit is a recruitment and retention incentive.

Representative Varela noted that the legislature needs to examine the total package of enhanced retirement benefits, including municipal firefighters, correctional officers, etc.

Representative Pena agreed with Representative Varela that a comprehensive review is needed.

Representative Lundstrom requested that a list of all proposals be prepared for consideration by the legislature.

Department of Public Safety, Motor Transportation Division (MTD); Retirement — Lt. Colonel Mark C. Rowley

The MTD is having a difficult time in attracting and/or retaining competent law enforcement officers due to the recent trend of other police agencies offering 20-year retirement and higher entry-level or competitive lateral-entry salaries and bonuses. The MTD is very concerned at the high employee turnover rate coupled with the increasing difficulty in recruiting and retaining employees, as evidenced by nearly a 26% turnover in trained commissioned personnel within a 30-month period.

Up until several years ago, the MTD had been a training ground for those applicants who sought to get their foot the door and then move on to better-paying law enforcement jobs. Commissioned officer turnover rates were as high as 19.5% during calendar year 2003. Significant salary increases allowed the division to retain employees and become more competitive in attracting qualified applicants. Unfortunately, the MTD is again competing with other law enforcement agencies in a highly competitive environment for both entry-level and experienced police officers. Police agencies within New Mexico and around the country are offering highly competitive salary and bonus incentives to encourage experienced police officers to lateral into their agencies. The MTD is now seeing a new trend of losing well-trained senior commissioned officers to other agencies that offer 20-year retirement and bonuses, in addition to being unable to attract qualified entry-level officers because the division does not participate in a 20-year retirement program.

Exit interviews indicate that the majority of employees who left the agency enjoyed working for the Department of Public Safety (DPS) and would have remained with the MTD if it offered 20-year retirement. This high turnover rate of experienced officers has resulted in a high degree of institutional memory loss and in an inefficient utilization of resources and appropriated funding for hiring and training these employees. It costs roughly \$50,000 to train a new employee to the point where the officer is able to perform the duties necessary to contribute to the overall mission of the agency.

In addition, different retirement plans among divisions within the DPS, coupled with an aggressive recruitment and lateral-entry program within the New Mexico State Police, is resulting in the potential loss of additional experienced MTD officers.

In an effort to ameliorate this situation, it is necessary to establish a compensation and benefit system for MTD police officers that will provide an avenue to attract qualified applicants, retain employees who contribute to the overall mission of the organization, motivate employees to maintain high standards, productivity and service and reward employees for exemplary achievement. This compensation and benefit system should recognize internal equity within the department and external competitiveness with other state and federal governments' pay and benefits.

Mr. Rowley believes that the DPS and the New Mexico Legislature have already taken bold and significant steps in resolving the law enforcement compensation problem

during the last several legislative sessions. Developing alternative pay bands and significant salary increases for the MTD and Special Investigations Division (SID) officers did not disrupt the separate personnel systems while simultaneously approaching parity within the law enforcement program and developing a competitive salary structure within the law enforcement community.

The second part of the equation to remain competitive within the law enforcement community is to designate legislatively Motor Transportation Police (MTP) officers and SID agents as "hazardous duty members" and move them into the State Police and Adult Correctional Officer Coverage Plan I during the upcoming 30-day legislative session. This action will place DPS officers in a retirement plan that is consistent with retirement benefits found in the majority of New Mexico law enforcement agencies. The actuarial study necessary to accomplish this is estimated to be completed during November, at which point it will be made available for review.

Mr. Rowley believes that the most pressing issue facing the MTP and SID today is the disparity in retirement plans within the DPS and within the New Mexico law enforcement community. Placing the MTP and SID officers into the State Police and Adult Correctional Officer Coverage Plan I will bring the law enforcement program closer toward parity, in addition to enhancing the agency's ability to retain trained, experienced officers and to recruit qualified officers to fill vacancies.

Mr. Rowley stated that the lack of 20-year retirement places the MTD at a competitive disadvantage with respect to recruitment and retention. He noted it costs approximately \$50,000 to train each officer and it is difficult to retain trained officers because of the retirement benefits.

Representative Lundstrom asked about port-of-entry enforcement. Mr. Rowley responded that the MTD has increased enforcement significantly and has identified 800 carriers that are not remitting weight distance tax.

Representative Larrañaga asked how much of the MTD's efforts are devoted to commercial vehicles. Mr. Rowley stated that 80% of the MTD's time is devoted to commercial vehicles. The remaining 20% is devoted to such activities as officer assist calls, altercations at truck stops, general vehicle safety, burglary, etc. These activities are appropriate because the MTD officers are police officers.

Representative Larrañaga asked if all divisions of the state police are included in the state police retirement plan. Mr. Rowley responded that only the MTD and the SID are not in the state police retirement plan.

Representative Varela suggested that, if retention is the problem, perhaps salary enhancement should be pursued. Mr. Rowley responded that survey data show that the number one reason people do not join the MTD is the absence of 20-year retirement, not salary.

Representative Garcia asked about the history of the MTD. Mr. Rowley responded, that over the years, the MTD has been a stand-alone department or a division within the state police, taxation and revenue, tourism and transportation departments.

Representative Garcia asked how often the MTD has approached the legislature for enhanced retirement. Mr. Rowley stated that the MTD has attempted four times to achieve 20-year retirement. Representative Garcia stated that it is important for the executive branch to make the retirement enhancement a priority.

Representative Garcia stated that he is opposed to return-to-work and asked how many MTD employees are return-to-work employees. Mr. Rowley responded that, of 125 employees, one is return-to-work.

Representative Garcia asked about urine-bomb enforcement. Mr. Rowley responded that if an MTD officer witnesses a urine bomb, the incident is cited as a hazardous material violation.

Senator Smith observed that the MTD retirement enhancement inequity is the fault of the legislature and executive.

Management Fees Alternative Investments — Bob Gish, PERA

Mr. Gish summarized the difference in fees between traditional and alternative investments as follows:

Traditional Assets vs. Alternative Investment Assets
(Private Equity, Hedge Funds, Real Estate, Others)
per \$100,000 Assets

COST	RETURN/RISK
Traditional Investments	Traditional Investments
Stocks (\$300)	Stocks 8% with 17% Std. Dev.
Bonds (\$200)	Bonds 5% with 4% Std. Dev.
Alternative Assets (AIAs)	Alternative Assets (AIAs)
Base Fees: \$1,500-\$2,000	Low Correlation to Stocks & Bonds
Private Equity	Private Equity 11% with 25% Risk
Hedge Funds	Hedge Funds 7.5% with 5-6% Risk
Real Estate	Real Estate 7.5% with 9% Risk

Whether using performance fees or flat-rate/standard fees, returns "SHOULD" be the same as other clients using the same manager for the same mandate. If over the long term (three to five years) the normal fee (NF) is not earned, the "expected" added value or the objective has not been achieved, lower fees do not justify lower returns. If an underperforming manager's contract is not terminated, it is in the funds' best interest to have the lower fee via a performance fee, where the manager will earn the base fee (BF),

which typically is less than the NF. A manager does not have to outperform the whole universe of investments, just the benchmark. The benchmark should reflect the manager's area of expertise. The fund should have other investment manager choices.

Representative Varela asked if the payment of fees is a separate transaction. Mr. Gish responded that the fees are deducted from the return on investment by the fund manager.

Representative Varela asked about criticisms he has heard about PERA investment in hedge funds. Mr. Gish responded that he believes that criticism is coming from those who would like to see the retirement system converted to defined contribution and who would like to benefit from such a conversion. He also noted that PERA is only investing in premier hedge funds (about 200 out of the 10,000 existing hedge funds) with large capitalization and an excellent track record for returns. PERA is seeking higher returns than from bonds and lower returns than from equities while significantly reducing risk from 17% in equities to 5% in hedge funds.

Representative Bratton asked if hedge funds create anything. Mr. Gish responded that hedge funds create wealth in the same sense that trading equities creates wealth. Representative Bratton urged caution with investing retirement money in hedge funds. He also noted that alternative investments totaling 15% of PERA assets will result in a doubling of management fees, from \$25 million to \$50 million annually.

Representative Larrañaga asked why alternative investment management fees are higher than those of traditional fund managers. Mr. Gish responded that traditional managers are limited to very specific investments, e.g., U.S. only, large cap, growth equities or foreign, small cap or value equities. Alternative investment managers are not limited in this way, and investors must pay for their expertise.

Representative Garcia stated that there is no regulation of hedge funds and urged caution when investing public funds.

New Mexico Film Investments; House Memorial 43 — Eric Witt, Director, Legislative/Political Affairs, Office of the Governor and New Mexico Producers Coalition (NMPC)

Mr. Witt stated that a majority of film production loans have been made to out-of-state production companies. One of the reasons is because of statutory requirements, such as the ability for local companies to demonstrate distribution capabilities and prudent investor standards. He said that the Governor's Office is exploring ways of providing other incentives to local producers.

Bill Conway and Karen Koch of the NMPC noted that only \$2 million has been made available to New Mexico producers. Ms. Koch stated that New Mexico producers believed they were in compliance with State Investment Council (SIC) rules, but they feel the rules were changed.

Representative Larrañaga asked if the Governor's Office has any recommendations. Mr. Witt said that the House Memorial 43 working group has prepared preliminary recommendations; however, the report needs further work before it can be released. He noted that the safeguards in current law are strict in order to protect taxpayer money. Ironically, if a production company satisfies all the requirements, the less likely it is to need a loan from the SIC. At the same time, Mr. Witt stated, it is in the interest of the state to encourage and support local production companies.

Representative Larrañaga asked if the Governor's Office would be recommending that a certain amount of money be set aside in a New Mexico-only fund. Mr. Witt responded that he believes the film investment program should be market-driven and not be a subsidy for marginal productions. He said that one alternative might be a tax credit rather than a loan.

Senator Smith asked when a draft of the working group report would be available. Mr. Witt indicated that a draft could be available in about a week.

Examination of Equity Strategies — Gary Bland, SIC

Mr. Bland summarized the financial condition of the land grant, severance tax and tobacco settlement permanent funds as follows:

New Mexico Permanent Funds

Investment results since 12/31/2002
(stated in \$000s)

	<u>Land Grant</u>	<u>Severance</u>	<u>Tobacco</u>	<u>TOTAL</u>
<u>Assets</u>				
Balance 12/31/02	6,255,967	3,123,175	56,602	9,435,744
<u>Contributions</u>				
1/01/03 to 6/30/03	127,427	1,031	43,759	
FY04	236,277	16,318	37,449	
FY05	320,809	12,371	38,009	
FY06	414,694	123,217	34,892	
FY07	398,602	24,073	36,239	
through 8/31/07	66211			
Total Contributions	1,564,020	177,010	190,348	1,931,378
<u>Distributions</u>				
1/01/03 to 6/30/03	166,392	85,476	43,759	
FY04	352,525	172,434	37,449	
FY05	422,198	173,249	38,009	
FY06	426,444	171,798	34,892	
7/01/06 to 06/30/07	438,945	170,972	18,119	
through 8/31/07	78,333	29,528		
Total Distributions	1,884,837	803,457	172,228	2,860,522

Net Contri/Dist	(320,817)	(626,447)	18,120	(929,144)
Adjusted Net Assets	5,935,150	2,496,728	74,722	8,506,600
Assets as of August 31, 2007	10,498,665	4,597,129	116,029	15,211,823
Investment Returns Since 12/31/02	4,563,515	2,100,401	41,307	6,705,223

Representative Varela asked about the cause of the subprime market problem. Mr. Bland responded that a major problem was collateral damage resulting from panic. He stated that a no-bid market emerged in which no investors were willing to purchase mortgages. Mr. Jacksha commented that some of the original problem was fraud on the part of lenders who overvalued property and borrowers who overstated earnings.

Senator Smith asked to what extent "flipping" was responsible for the subprime crisis. Mr. Bland presented anecdotal evidence of a "flipper" in Seattle who purchased five homes using equity from his primary residence. Now, he is unable to sell the five houses because lenders will not make mortgages to potential buyers. If the situation persists, the "flipper" may have to walk away from three of the properties.

Discussion of Agenda Items for the November 7, 2007 Meeting — Proposed Legislation; Actuarial Update; PERA

Senator Smith requested that the committee be presented with drafts of the bills that the committee endorsed during the 2006 interim, e.g., House Bill 313 regarding return-to-work.

Other Business

There was no other business brought before the committee.

Adjourn

The committee adjourned at 4:00 p.m.